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# A Survey on Socio-economic Development and FDI-led Strategy

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## Abstract

This paper examines the causal linkage of foreign direct investment (FDI) strategy on socio-economic development practiced by the Association of Southeast Asian Nations (ASEAN). Based on the literature survey on the FDI and country development, this paper argues that FDI strategy has the important effects on socio-economic development through three channels: economic growth with inward FDI growth as the most essential engine; innovation and technological advance and knowledge spillovers from the FDI-based firms on the economy; and human capital accumulation from the FDI-based firms. The findings based on the secondary data are likely to support the role of inward FDI in socio-economic development. Even though, the ASEAN Economic Community Roadmap helps to encourage the high level of FDI and to optimize the socio-economic development in the ASEAN, but it still lacks the implementation and enforcement of the ASEAN agreements. In the long run, the regional economic monitoring and surveillance process must be evolved to drive the ASEAN to become the ASEAN community in 2015. It is expected that these practical actions will improve the tendency of the FDI flows, develop the foundation of the market system in the economy, and thus further lift the level of socio-economic development in the Southeast Asian region.

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**Keywords:** Foreign direct investment; Socio-economic development; Regional integration; ASEAN

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## 1. Introduction

The initiation of ASEAN Economic Community (AEC) has started to take shape since 2007. The leaders from the 10 members of the Association of Southeast Asian Nations agreed to adopt the AEC Blueprint which serves as a master plan for achieving the ASEAN community in 2015. The main objectives of the AEC blueprint were to be a single market and production base, competitive economic region, equitable economic development and integration with the global economy [1]. At this rate, the emergence of AEC raises questions about the prospects and challenges for its future development. In other words, the AEC now becomes a potential engine for socio-economic development in the Southeast Asia. Although there are many obstacles in the country's development that arise from the differences among ASEAN nations, it has a variety of opportunities to reach the high level of ASEAN's development. To date the Southeast Asian region has become one of Asia's most attraction destinations for foreign direct investment among

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other emerging countries. That is because the establishment of the ASEAN Investment Area Agreement was begun in 1998 and enlarged through the ASEAN Comprehensive Investment Agreement (ACIA) in 2007. Under these circumstances, the prospects of FDI and the strategic challenges of multinational enterprise (MNE) could lead the way to finally developing the market system: the product market, labor market and capital market. Certainly, these market developments will pass through the socio-economic development and welfare improvement in the ASEAN economies. The argument presented here is to ascertain whether since the declaration of the AEC in 2007 up to now, the FDI strategy has played a role as an essential engine for economic growth and hence socio-economic development in ASEAN economies. However, the existing literature seldom deals with these important topics. Based upon both macro and micro data, this paper attempts to focus on such critical issues on the topic: what are the socio-economic benefits from the entry of multinational enterprises? how do the ASEAN investment agreements explain the foreign investment growth? and how is the AEC roadmap important to improve the socio-economic development? The discussion of this study sheds some light on the question of foreign direct investment, thereby contributing to the existing literature on multinationals from ASEAN emerging countries.

The questions of the ASEAN's future are explored below in two parts. The first part examines the level of foreign direct investment inflows to ASEAN that strongly suggests the socio-economic development. The assessment of this impact is measured by economic growth per capita, innovation and technological advance and knowledge spillovers, and human capital accumulation. The next part describes the importance of FDI attraction strategy through the emergence of AEC. That is because the AEC is the latest goal of regional economic integration that has arisen out of the continuing search for a vehicle for Southeast Asian regional cooperation. The study argues to shed light on the appropriate activities of FDI strategy to pursue in order to encourage the high level of FDI and to optimize the socio-economic development in the ASEAN. It also explains the benefits of the FDI strategy and the supporting activities to the socio-economic development. Though, these benefits are rooted in the many variations to be found in the societies and economies of such ASEAN countries. Moreover, the impacts of the global economic and financial crises on the development are also explored. It indicates that the crises gave the new regional arrangement with a focus on concrete and practical roadmap.

The remainder of the paper is organized as follows. Section 2 presents the stylized facts of the presence of FDI inflows to ASEAN economies and their socio-economic development. Section 3 discusses the role of FDI attraction strategy in socio-economic development upon the AEC roadmap. We conclude our study in a final section.

## 2. FDI and Socio-Economic Development

It is widely believed that foreign direct investment is a powerful driving engine for socio-economic development in a line passing through product market, labor market and capital market as shown in Fig.1. Among the different motives

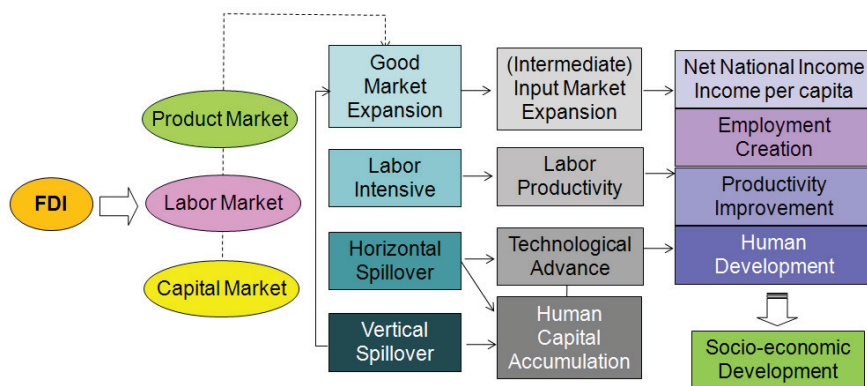


Fig. 1. The FDI Model of Socio-Economic Development

of FDI, [18] categorized the types of FDI into the market-seeking FDI, the-efficiency seeking FDI, the resource-seeking FDI and the created-asset-seeking FDI. Whatever the types of FDI, the benefits from the entry of multinational enterprises include market expansion, employment creation, horizontal spillovers through productivity improvement,

human capital accumulation, innovation and technological advance, and vertical spillovers via backward and forward linkages to (intermediate) input markets [4]. All of these benefits are expected to bring about higher economic and employment growth which is the most important tool for improving socio-economic development in the country.

It has a large number of documentary studies of the impacts of FDI inflows on product and factor market development in the economy. For instance, the recent studies of [12], [19] and [5] supported the notion that the FDI has a positive effect on economic growth in developing countries. Moreover, the findings of [6], [7] and [10] indicated the positively significant role of FDI on total factor productivity. Inward FDI resulted in an increase in productivity, not only in OECD countries, but also countries in Asian region. Unfortunately, empirical evidence regarding the direct impact of FDI on socio-economic development is roughly limited. There were some works to capture the effect of socio-economic development on FDI decision [15, 16]. The results showed that the higher level of human development index proxy for socio-economic development has a positive influence on the cross-border acquisition decision. In fact, the impacts of FDI on socio-economic development deal with economic, social and political determinants. Among these various factors, the level of socio-economic development upon the FDI inflows presented here depends principally on the GDP per capita as proxy for economic growth, the research and development expenditure as a percentage of GDP as proxy for innovation and technological advance, and education as proxy for human capital accumulation. Based on the World Bank database [20], the surveys on five ASEAN economies over 14 years reflect the views of the causality between FDI growth and socio-economic development as shown below.

Table 1. Selected Socio-economic Indicators of ASEAN countries, 1995-2008

| Indicators  | 1995      | 1997      | 2000      | 2005      | 2008      |
|---|-----------|-----------|-----------|-----------|-----------|
| GDP per capita (in 2000 US\$)                       |           |           |           |           |           |
| Indonesia   | 799.30    | 875.95    | 733.31    | 914.59    | 1,052.43  |
| Malaysia  | 3,581.94  | 4,022.84  | 4,055.55  | 4,529.60  | 5,077.93  |
| Philippines   | 982.03    | 1,045.45  | 1,048.07  | 1,185.37  | 1,314.22  |
| Singapore   | 20,518.77 | 22,281.63 | 23,814.56 | 28,408.52 | 30,049.57 |
| Thailand  | 2,011.82  | 2,057.06  | 1,943.23  | 2,359.64  | 2,608.24  |
| Research and development expenditure (% of GDP)     |           |           |           |           |           |
| Indonesia   | -         | -         | 0.06      | 0.04      | -         |
| Malaysia  | -         | -         | 0.46      | -         | -         |
| Philippines   | -         | -         | -         | 0.11      | -         |
| Singapore   | -         | 1.47      | 1.88      | 2.27      | -         |
| Thailand  | -         | 0.10      | 0.25      | 0.23      | -         |
| Secondary Gross Enrolment Rate (%)                  |           |           |           |           |           |
| Indonesia   | 49.44     | 56.69     | 52.81     | 60.64     | 70.18     |
| Malaysia  | -         | -         | 66.16     | 70.29     | 69.05     |
| Philippines   | 76.48     | 75.41     | -         | 83.53     | 82.71     |
| Singapore   | -         | -         | -         | -         | -         |
| Thailand  | 48.54     | 57.86     | -         | 70.89     | 74.97     |
| Adult Literacy Rate (% of people ages 15 and above) |           |           |           |           |           |
| Indonesia   | -         | -         | -         | -         | 92.19     |
| Malaysia  | -         | -         | 88.68     | -         | -         |
| Philippines   | -         | -         | 92.60     | -         | 95.42     |
| Singapore   | -         | -         | 92.54     | -         | -         |
| Thailand  | -         | -         | 92.64     | 93.50     | -         |

Table 1 compares the socio-economic development of ASEAN countries during the period of 1995 to 2008. It is seen that real income per capita, technological improvement, adult literacy and education have tremendously improved from time to time. Surprisingly, the financial and economic crises in 1997 and 2008 had not caused the socio-economic development slowdown. Data on FDI and socio-economic indicators for ASEAN are further used to examine the relationship between FDI and socio-economic development. The basic findings (Fig.2) indicate that the effect of ASEAN's FDI inflows on the economic development is indeed essential. The growth of FDI tends to increase

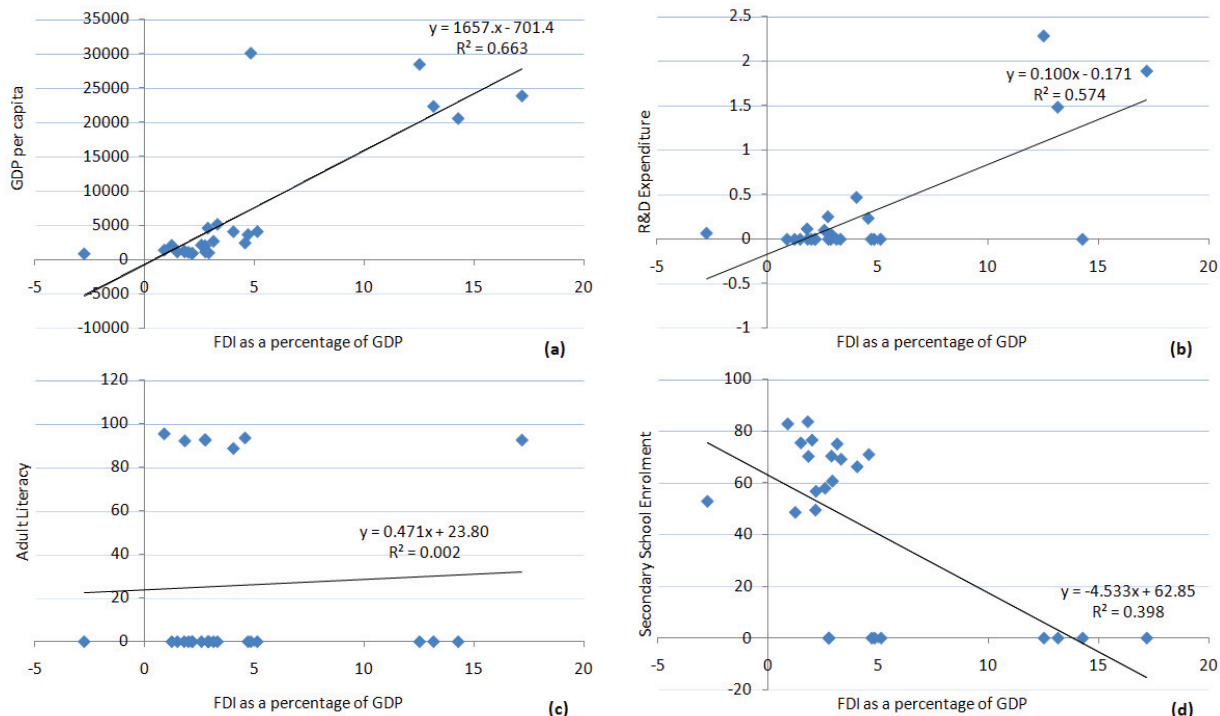


Fig. 2. (a) FDI and GDP per capita, (b) FDI and R&D Expenditures, (c) FDI and Adult Literacy (d) FDI and Secondary School Enrolment of the five selected ASEAN countries, 1995-2008

the income per capita and technology improvement proportionately. It is also found that there is no systematic link between FDI growth and literacy, whereas inward FDI has negatively statistical relationship with the education attainment. As we known that an educated labor can learn new technology faster and gives more productive man-hours. Moreover, the quality of labor is one of main factors for FDI decision even the problem of lowly skilled workers can be mitigated by lowering the wages. The higher level of human capital indicates the availability of skilled workers, which can attract foreign investors to the country. However, FDI can have a positive impact on human development. In other words, the impacts of FDI on human development in ASEAN countries may very well depend on the ASEAN's policies and their institutions, the supporting activities of FDI agencies (both proactive and defensive activities), and the closer co-ordination of FDI strategies with the programs on education, job-training, research and employment. All of these contributions could have valuable benefits to human capital development in the ASEAN economies.

### 3. FDI Attraction Strategy

Based on the existing literature, FDI growth is influenced by regional economic integration policy. For example, the studies of [8], [11] and [9] suggested that the regional economic integration is an important factor of inward FDI in developing countries. The higher degree of regional integration encourages the FDI inflows, especially intra-ASEAN FDI flows. Therefore, it might say that the socio-economic development in the economy is based on not only foreign investment, but also the deepening of regional economic integration. At this rate, this paper states the FDI strategy under the AEC blueprint which is one of the most effective means to rapidly increase the productivity of the ASEAN economy. There is relatively little discussion about the FDI attraction strategy, in part of the difficulty of implementing the ASEAN investment policies that generates the knowledge intensity of the ASEAN economy and in part of the activities of lifting the level of FDI inflows.

The Southeast Asian economies recently agreed to deepen regional integration through the establishment of the ASEAN community in 2015. The ASEAN community depends on the three pillars of economic cooperation: the ASEAN political-security community, the ASEAN economic community and the ASEAN socio-cultural community.

The roadmap was put in place to implement the blueprint of these three communities over the last decade. The vision of the AEC is to establish a highly competitive single market that promotes equitable economic development, as well as facilitating their integration with the global community [1]. Towards the AEC vision, ASEAN adopted the AEC blueprint which outlines the core elements to be taken. First, to become a single market and production base, the AEC shall liberalize and facilitate of free flow of goods, services, investment, capital and skilled labor. Second, to be competitive economic region, the AEC lays the foundation for competition policy, consumer protection, intellectual property rights, and ratifying transport agreements. Third, to achieve equitable economic development, the AEC makes an effort to study and develop the small and medium enterprises (SMEs) and the initiative for ASEAN integration work plan. Finally, to integrate ASEAN into the global economy, the AEC makes the entry into force of free trade agreements.

The role of regional investment integration in ASEAN began with the ASEAN Investment Area agreement launched in 1998. Afterwards, it was enlarged through the ASEAN Comprehensive Investment Agreement in 2007 in accordance with the AEC blueprint. The ACIA is one of the elements towards a single market and production base which enhances greater liberalization in investment and increased investment protection for both ASEAN investors and ASEAN-based foreign investors. In this sense, it challenges increasing competition for foreign investors. From the statistics of [2], foreign direct investment, both intra-ASEAN and extra-ASEAN FDI, accounted for almost all of total gross capital inflows to ASEAN in the recent years. The inward FDI sharply rose by 112% from 2004 to 2007 with a considerable increase in intra-ASEAN FDI by 245% and an expansion in extra-ASEAN FDI by 100%. Unsurprisingly, due to global economic crisis, the FDI inflows in 2008 declined by 37% from a tremendous decrease in the extra-ASEAN FDI by 42% and in intra-ASEAN FDI by 2%. The sharp drop in extra-ASEAN FDI was because the inward FDI values from EU, the U.S. and Japan felt by half. Similarly, the FDI inflows in 2009 also declined by 19% which resulted from a decline in extra-ASEAN FDI and intra-ASEAN FDI by 12% and 44%, respectively. Indeed, there are many reasons why the FDI inflows to ASEAN have tremendously dropped during the last decade. It may be because the ASEAN faced the lack of the complete information for decision making, the adoption and the implementation of the FDI attraction strategies constructed from the incomplete information, and the lack of the monitoring and surveillance. However, it is believed that the AEC blueprint is ultimately both appropriate and desirable in the ASEAN interest. The AEC achievements will bring together the ASEAN countries to improve their well-being. One of them is shown in the sharp increase in FDI inflows in 2010 by 99% with an increase in extra-ASEAN FDI 94% and in intra-ASEAN FDI 133%. Hence, it might say that to create the sustainable socio-economic development through FDI, the FDI strategies must be established in clear direction and practical action.

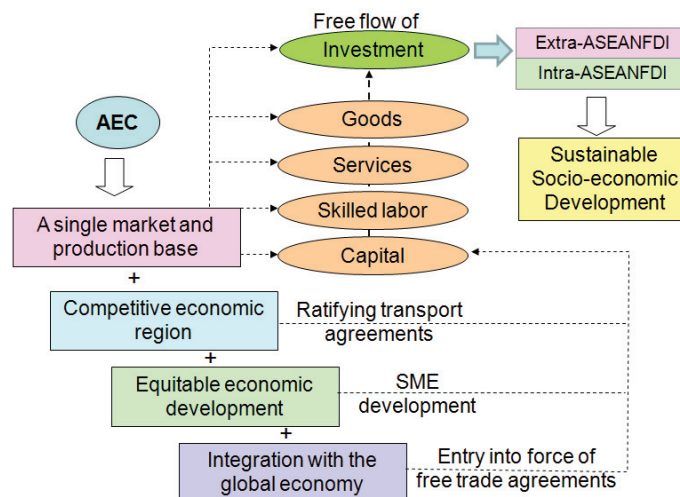


Fig. 3. The Socio-Economic Development Framework based on the AEC Blueprint

The linkage of the FDI and the AEC roadmaps as shown in Fig.3 explains the way to reach the goal of the sustainable socio-economic development in ASEAN. The core elements in the AEC blueprint serve as the foundation for developing the societies and economies of such ASEAN countries. The activities in each core element are together



linked to improve the market system in the economy. First of all, the "freer investment" framework associated with investment liberalization and investment facilitation has direct effect on FDI inflows, both extra-ASEAN FDI and intra-ASEAN FDI. The practical actions for free flows of investment include the reduction/elimination of investment restrictions and impediments; the harmonization of investment measures to facilitate movement of investment; the promotion of regional clusters and production network through ASEAN industrial cooperation initiatives; and the investment protection and settlement of investment disputes. [14] studied the progress towards investment liberalization. They found that the FDI climate in ASEAN was attractive, but it still lacks the transparency and the readiness in screening and appraisal procedures. The impediments to FDI in ASEAN are not only the lacks of rules and regulations of investment facilitation, but also the difficulty of implementation and enforcement of the ASEAN investment agreements. However, this work also introduced many directions to achieve the investment liberalization such as the acceleration of the implementation of the ACIA, and the improvement in human resource development.

Second, the "freer trade" framework regarding trade liberalization and trade facilitation has both direct and indirect effects on FDI growth. The practical actions for free flows of good concern with the elimination of tariff barriers with common effective preferential tariffs (CEPT) program; the elimination of non-tariff barriers; the implementation of rule of origin; and the enhancement of trade facilitation and custom integration such as the harmonization of standardized trade and custom, processes, and procedures through ASEAN single window, and standards and conformance procedures. [3] made a survey on trade facilitation in ASEAN countries and found that it still has the inconvenience in custom procedure and the lack of transparency. However, [13] noted that the ASEAN has the efforts to improve the custom clearance procedures. It is believed that whenever the ASEAN single window program is fully implemented, it strongly encourages increasing trade flows, vertical FDI and export-platform FDI flows to the ASEAN economies.

Third, the "freer services" framework has direct and indirect effect of FDI inflows. The practical actions for service liberalization focus on the attempt to reduce the restrictions on trade in services for logistics services, insurance, banking and capital market. In order to achieve the service liberalization, the hard and soft logistics developments are also provided. One of them is to develop the infrastructure in order to link together the countries in Asian region. Nowadays the infrastructure development in ASEAN has been improved in which it is able to further perform many economic activities through trade and investment. Moreover, [17] developed the Geographical Simulation Model to predict the effects of infrastructure development projects on the economy. The results showed that an infrastructure development in ASEAN may lead to the shifts in economic activities among Asian region.

Finally, other activities which make a closer coordination of FDI strategies include SME development; human resource development in the line with education program, training program, R&D program; and monetary and financial integration. The practical actions under the SME development consist of the establishment of a comprehensive SME service centre, an internship scheme for skills training, a regional SME development fund, and capacity building program. All of them are as the supporting activities of FDI attraction strategies. In addition, the practical actions under monetary and financial integration are to strengthen ASEAN capital market development and integration, and allow greater capital mobility. It is viewed that Asian Bond Markets Initiative launched in 2000, and Chiang Mai Initiative Multilateralism with China, Japan and the Republic of Korea established in 2003 have resulted in the recovery of ASEAN economy from the Asian financial crises in 1997 and global economic crisis in 2008. The financial service liberalization, capital account liberalization and capital market development help to facilitate greater trade and investment flows to the ASEAN region. All of these activities could have several valuable benefits to the ASEAN economy. At least it can lift the level of FDI flows which may better help the ASEAN in regard to increase in socio-economic development.

In fact, the AEC blueprint is only the outlines where the ASEAN aims to achieve in 2015. From the above review of the literature, it is clear that the strategic approaches under the AEC blueprint are able to raise the level of FDI flows. In particular, the strategic approach on the basis of "free flows of trade" increases the vertical FDI and export-platform FDI, but it is particularly unclear whether it affects the horizontal FDI. It has also seen the implementation of other strategic approaches, aimed at increasing the level of FDI flows to ASEAN. In other words, it helps to increase the high level of economic and social development. Even though the FDI attraction strategy under the AEC can well enhance the socio-economic development in the ASEAN, the ways to reach it are quite difficult. Moreover, financial and economic crises are a little bit behind the difficulty of socio-economic development which may influence the extent of the entry of multinationals. If the ASEAN fills this gap, the FDI inflows will bring about the most efficient and economical use of resources. More important thing is that much remains to be done to extend recent research,

in particular, the welfare effects of ASEAN investment liberalization policies towards the establishment of ASEAN economic community.

#### 4. Concluding Remark

In this paper we examine the relationship between the inward foreign direct investment flows to ASEAN and the level of socio-economic development. The economic growth indicators are measured by income per capita and R&D expenditures, whereas the social development indicators are measured by the adult literacy and school enrolment. The results strongly suggest the positive linkage of FDI and the economic growth, but the negative relation to the social development. For policy decisions, the survey on socio-economic development and FDI may not be as relevant as whether they are typically different in measurable socio-economic development. In most of this outcome, there does seem to be some edge in favor of benefits from FDI. Moreover, the paper also shows how to addresses the question of how do the ASEAN investment agreements explain the foreign investment growth? and how is the AEC roadmap important to improve the socio-economic development? The socio-economic development model based on the FDI attraction strategy and the AEC blueprint is employed to explain. It indicates the appropriate economic activities of the AEC roadmap to encourage the high level of FDI and to optimize the socio-economic development in the ASEAN, on the one hand, and the lacks of the implementation and enforcement of the ASEAN agreements, on the other hand. In the long run, the regional economic monitoring and surveillance process which is the important mechanism in ASEAN must be evolved to drive the ASEAN to become the ASEAN community in 2015. These practical actions, in turn, will improve the tendency of the FDI flows, develop the foundation of the market system in the economy, and thus further lift the level of socio-economic development in the Southeast Asian region.

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